



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

State Auditor's Office

*For the Two Fiscal Years Ended
June 30, 2022*

AUGUST 2023

LEGISLATIVE AUDIT
DIVISION

22-20

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting and many staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2021, was issued June 21, 2022. The submission deadline for the Single Audit Report for the two fiscal years ended June 30, 2023, is March 31, 2024.

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LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
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August 2023

The Legislative Audit Committee
of the Montana State Legislature:

We are pleased to provide our financial-compliance audit report on the State Auditor's Office (office) for the two fiscal years ended June 30, 2022.

The office's financial schedules are generated from SABHRS and management is responsible for the notes to the financial schedules. We issued qualified opinions on each of the fiscal year's financial schedules which means the reader should understand the misstatements outlined in the opinion when using the financial schedules.

We focused our audit efforts primarily on insurance and securities licenses and permits revenues, insurance premium tax revenues, and Montana Reinsurance Program activities. We also reviewed transfers to retirement systems administered by Montana Public Employees' Retirement Administration from the General Fund and required by state law. In addition, we evaluated and tested the office's controls over financial activity and determined the office's compliance with selected state laws and federal regulations. This report contains seven recommendations to the office related to internal controls, errors in accounting transactions, and compliance with state accounting policy and federal regulations.

The office's written response to the audit is included in the audit report on page C-1. We thank the Commissioner of Securities and Insurance and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

State Auditor's Office

Troy Downing, State Auditor, Commissioner of Securities & Insurance

Mary Belcher, Deputy State Auditor

Molly Plummer, Chief of Staff

Frank Cote, Governmental Affairs Director

Brett Olin, Deputy Securities Commissioner

Bob Biskupiak, Deputy Insurance Commissioner

Ole Olson, Chief Legal Counsel

Nikki Davison, Finance Manager (through June 30, 2023)

Amber Thorvilson, Chief Financial Officer (effective July 24, 2023)

For additional information concerning the State Auditor's Office, contact:

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MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

State Auditor's Office

FOR THE TWO FISCAL YEARS ENDED JUNE 30, 2022

A report to the Montana Legislature

BACKGROUND

The State's Auditor's Office (office) protects Montana's consumers through insurance and securities regulation. The elected Montana State Auditor serves as the Commissioner of Securities and Insurance.

The office is organized into three divisions: Central Management, Insurance, and Securities.

The Central Management Division is responsible for the central business operations of the office, such as accounting, human resources, and information technology services.

The Insurance Division investigates insurance code and rule violations, collects taxes, resolves complaints, provides insurance licenses, reviews rates, and approves continuing education. This division also administers the Montana Reinsurance Program.

The Securities Division is responsible for the registration of securities issuers, salespeople, investment advisers, broker-dealers, investment adviser representatives, and for conducting investigations.

Commissioner:
Troy Downing

The 2019 Legislative Session created the Montana Reinsurance Program, subsidized with federal funds, to stabilize the individual health insurance market, maintain competition, and reduce premiums. In fiscal year 2022, the office made its first reinsurance program distributions to insurance companies.

Distributions totaled \$25.5 million and comprised \$17.7 million and \$7.8 million in federal and state funds. This report includes three recommendations regarding improvements to the office's compliance with federal regulations for the reinsurance waiver program. None of the recommendations have an impact on the distribution of funds. However, the office experienced challenges in identifying and complying with nonfinancial federal compliance requirements.

AUDITOR'S OPINION (page A-1): QUALIFIED

Due to misstatements identified during the audit, which are discussed in further detail in Recommendations #1 and #2 on pages 3 through 6, we issued a qualified opinion on the office's fiscal year 2022 and 2021 financial schedules. This means the reader should understand the misstatements outlined in the opinion when using the financial schedules.

For the full context of the office's financial activity, see the financial schedules and notes beginning on page A-5.

RECOMMENDATIONS:

In this report, we issued the following recommendations:

To the office: 7

To the legislature: 0

There were no recommendations in the prior audit report.

RECOMMENDATION #1 (page 3):

Accounting and Financial Reporting, Internal Control

We recommend the office enhance internal controls over transfers to component units of the state and comply with state accounting policy by recording such transactions as Intra-Entity expense.

Office response: Concur

(continued on back)

For the full report or more information, contact the Legislative Audit Division.

leg.mt.gov/lad

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RECOMMENDATION #2 (page 4):

Accounting and Financial Reporting, Internal Control

We recommend the office enhance internal controls to fully consider applicable accounting criteria and to only record transactions that are necessary and in accordance with applicable and relevant accounting criteria.

Office response: Concur

RECOMMENDATION #3 (page 6):

Internal Control

We recommend the office enhance internal controls over drafting and reviewing the financial schedule note disclosures.

Office response: Concur

RECOMMENDATION #4 (page 7):

Accounting and Financial Reporting, Internal Control

We recommend the office review its Schedule of Expenditures for Federal Awards (SEFA) reporting package for completeness and accuracy prior to submission.

Office response: Concur

RECOMMENDATION #5 (page 9):

Federal Compliance, Internal Control

We recommend the office enhance internal control and comply with federal regulations for suspension and debarment and reporting.

Office response: Concur

RECOMMENDATION #6 (page 11):

Federal Compliance, Internal Control

We recommend the office enhance internal controls to ensure written policies and procedures for cash management exist for the federal waiver program and comply with federal regulations by maintaining such policies and procedures.

Office response: Concur

RECOMMENDATION #7 (page 12):

Federal Internal Control

We recommend the office enhance internal controls to establish a documented review of its SF-425 report.

Office response: Concur

REPORT ON INTERNAL CONTROL AND COMPLIANCE

(page B-1):

In this report, we identified the following:

Material Weaknesses in Internal Control: 2

Significant Deficiencies in Internal Control: 1

Material Non-Compliance: 0

Other Matters: 0

For the full context of this information, including the distinction between the types of items reported, see the report beginning on page B-1.

Chapter I – Introduction and Background

Introduction

We performed a financial-compliance audit of the State Auditor's Office (office) for the two fiscal years ended June 30, 2022. The objectives of the audit were to:

1. Obtain an understanding of the office's internal controls to the extent necessary to support the audit of the office's financial schedules and, if appropriate, make recommendations for improvements in internal and management controls of the office.
2. Determine whether the office's financial schedules for each of the two fiscal years fairly represent the results of operations and changes in fund equity in accordance with the state accounting policy.
3. Determine whether the office complied with selected state laws and federal regulations directly affecting the financial schedules.

We addressed these objectives by focusing our audit efforts primarily on insurance and securities licenses and permits revenues, insurance premium tax revenues, and Montana Reinsurance Program activities. We also reviewed transfers from the General Fund to retirement systems administered by Montana Public Employees' Retirement Administration required by state law. In addition, we evaluated and tested the office's controls over financial activity and determined the office's compliance with selected state laws and federal regulations.

The Montana Reinsurance Program, subsidized with federal funds, aims to stabilize the individual health insurance market, maintain competition, and reduce premiums. The Montana Reinsurance Association, a nonprofit legal entity, was created by the 2019 Legislative Session to administer the program in conjunction with the office. This program was fully established in late fiscal year 2020 with claim payments beginning in fiscal year 2022, reflected as Grants from State Sources and Grants from Federal Sources on the Schedule of Total Expenditures and Transfers-Out.

Office Background and Organization

The office oversees the insurance and securities industries in the state of Montana. The office licenses and regulates insurance companies and agents within the state and regulates and registers security dealers. The State Auditor is elected and serves as the Commissioner of Insurance and Securities. The State Auditor is also a member of the State Land Board and the Hail Insurance Board.

Table 1 (see page 2) summarizes the divisions or activities that are presented on the Schedules of Expenditures & Transfers-Out starting on page A-9.

Table 1
Office Divisions and Activities

Division or Activity	Description
Central Management Division	This division is responsible for the office's administrative, budgeting, personnel, information technology, and accounting functions. The division also supports the Commissioner as he fulfills his duties on the State Land Board and the Hail Insurance Board.
Insurance Division	This division regulates the insurance industry in Montana. Its duties include: resolving insurance consumer inquiries and complaints about agents, coverage, and companies; licensing and reviewing the rates and financial condition of insurance companies; collecting the insurance premium tax; approving forms used by insurance companies; licensing, testing, and administering a continuing education program for insurance agents; and investigating insurance code and rule violations. This division also administers and provides oversight, in conjunction with the Montana Reinsurance Board, of the Montana Reinsurance Program.
Local Assistance to Counties	The office distributes General Fund moneys to the Montana Public Employees' Retirement Administration for the Firefighters' Unified Retirement System, the Volunteer Firefighters' Compensation Act, and the Municipal Police Officers' Retirement System. The Local Assistance to Counties Program has no approved FTE and is primarily administered through the FTE of the Insurance Division.
Securities Division	This division is responsible for administering and enforcing the Securities Act of Montana. The division is responsible for registering securities issuers, salespeople, investment advisers, broker-dealers, and investment adviser representatives. It also investigates instances of unregistered or fraudulent securities transactions.

Source: Compiled by Legislative Audit Division.

The office was authorized 71.5 full-time equivalent (FTE) staff for the 2023 biennium, which includes 4.0 modified FTE positions that are encompassed in the Central Management Division (0.5 FTE) and Insurance Division (3.5 FTE) counts below and 10 personal staff appointed by the Commissioner. Two modified FTE in the Insurance Division are funded via a statutorily mandated fund transfer from Montana State Fund; funds are used for personal services costs of the Insurance Division for staff who review workers' compensation issues. When the amount received from Montana State Fund is not fully utilized by the office, the remainder is returned.

The following table depicts changes in office FTE over the last four biennia.

Table 2
State Auditor's Office FTE Including Appointed Staff
2017-2023

	2017 Biennium	2019 Biennium	2021 Biennium	2023 Biennium
Central Management Division	18.80	18.00	16.00	15.50
Insurance Division	51.90	53.50	45.00	44.00
Securities Division	10.80	11.62	13.50	12.00
Total	81.50	83.12	74.50	71.50

Source: Compiled by Legislative Audit Division.

While office responsibilities have increased with addition of the Montana Reinsurance Program, the workload is spread among fewer staff.

Chapter II – Accounting Findings and Recommendations

Distributions to Retirement Systems

The office recorded payments to the Montana Public Retirement Administration (MPERA) using an incorrect account, leading to misclassified expenditures of approximately \$40 million annually for each year of the audit period.

The office transfers funds from the General Fund to MPERA for the Municipal Police Officers' Retirement System, the Firefighters' Unified Retirement System, and the Volunteer Firefighters' Compensation Act retirement program, per state law. The transfers are recurring transactions each year.

Our Department of Administration audit (#22-13) identified misclassifications in supplemental contribution payments from the General Fund to the retirement systems. Because the office's transfers to the retirement systems are similar, as part of this audit we considered whether the office's financial records also contained misclassifications.

Per state accounting policy, the Local Assistance expenditure account range is used for disbursements from the state to units of local government to be used without specific restrictions. The payments to MPERA, a component unit of the state, do not represent monetary disbursements to local governments for unrestricted use. Instead, the activity meets the definition of an Intra-Entity expense, or transaction between a fund of the primary government and a component unit or between two component units, and should be recorded as such. Because the office recorded transactions outside of state accounting policy requirements, material errors exist in its accounting records and on its Schedules of Total Expenditures and Transfers-Out, as reflected in Table 3.

Table 3 <u>MPERA Distribution Errors</u> Over/Understated Amounts by Fiscal Year		
Schedule of Expenditures	Fiscal Year 2021 Amount	Fiscal Year 2022 Amount
Local Assistance to Counties Program Local Assistance from Other Sources Intra-Entity Expense	Overstated \$39.0 million Understated \$39.0 million	Overstated \$41.0 million Understated \$41.0 million

Source: Compiled by Legislative Audit Division.

Office personnel represented the activity has been recorded as Local Assistance for a long period of time.

We classified this as a material weakness in internal controls in the Report on Internal Control and Compliance on page B-1.

RECOMMENDATION #1

We recommend the State Auditor's Office:

- A. *Enhance internal controls to ensure transfers to Montana Public Employees' Retirement Administration are accurately classified in the state's accounting records.*
- B. *Ensure transfers to Montana Public Employees' Retirement Administration are recorded as Intra-Entity expense, as required by state accounting policy.*

Montana Reinsurance Program

The Montana Reinsurance Program was created by the 2019 Legislative Session. The program is subsidized with federal funds and state assessments, and its purpose is to stabilize the individual health insurance market, maintain competition, and reduce premiums. The Montana Reinsurance Association, a nonprofit legal entity, was also created by the 2019 Legislative Session to administer the program in conjunction with the State Auditor's Office (office). The program was fully established in late fiscal year 2020 and administrative payments began in fiscal year 2021. The first claim payments to insurance companies totaling \$25.5 million were made in fiscal year 2022 and were comprised of \$17.7 million and \$7.8 million in federal and state funds. Both costs are reflected as Grants from State Sources and Grants from Federal Sources on the respective Schedules of Total Expenditures and Transfers-Out.

Recommendations #2, #3, and #4 are related to accounting and reporting for the Montana Reinsurance Program activity.

Unnecessary Accounting Entries

Working together, the office and the Department of Administration's accounting staff processed unnecessary adjustments to Montana Reinsurance Program activity at fiscal year-end 2022. Entries included eliminating valid current year expenditures and creating false balances in property held in trust (liability) accounts.

In approximately November 2021, as part of our audit of the state's Annual Comprehensive Financial Report (ACFR), we determined the Montana Reinsurance Association (MRA) is a discretely presented component unit of the state. This means the financial activity of the MRA must be included in the state's ACFR in columns and rows separate from the financial activity of the state. During fiscal year-end 2022, office and Department of Administration accounting staff worked together to reflect the MRA's activity on the state's accounting records. At the time, the office was advised to record entries to zero out fund balance and reflect property held in trust for unexpended balances held in the state special revenue fund account. The office also recorded prior year entries in its fiscal year 2022 accounting records to retroactively apply the same logic to ending fiscal year 2021 balances. This involved direct entries to fund balance and reductions in expenditures activity. While prior year entries

are permitted by state accounting policy, this process should only be used when correcting entries are necessary to address errors in prior year information. At the time the prior year entries were made, the office believed it was correcting an error.

The criteria used to support this accounting treatment require monies held on behalf of another entity to be reported as property held in trust at fiscal year-end. When the entries were made, the office and Department of Administration staff believed the funds received from insurance companies and held in the state's treasury at fiscal year-end ultimately belonged to the MRA and not the state. However, insurance companies are required by statute to pay the assessment to the office. As a result, the money received is considered a mandatory non-exchange transaction, such as taxes, and funds collected belong to the state. This means the above-described adjustments to record property held in trust were unnecessary because the funds belong to the state, not to the MRA.

This resulted in the following errors in the office's financial schedules for fiscal year 2022.

Table 4 <u>Montana Reinsurance Program Errors</u> Fiscal Year 2022 Financial Schedules	
Schedule of Changes in Fund Equity	Over/Understated & Amount
State Special Revenue Fund	
Direct Entries to Fund Equity	Overstated \$10.0 million
Total Additions	Overstated \$10.0 million
Budgeted Expenditures & Transfers-Out	Understated \$12.1 million
Prior Year Expenditures & Transfers-Out	Overstated \$10.0 million
Total Reductions	Understated \$2.1 million
Ending Fund Equity	Understated \$7.9 million
Schedule of Expenditures	Over/Understated & Amount
Insurance Program	
Grants from State Sources	Understated \$2.1 million
Expenditures & Transfers Out by Fund – State Special Revenue Fund	Understated \$2.1 million
Actual Budgeted Expenditures & Transfers-Out	Understated \$2.1 million
Prior Year Expenditures & Transfers-Out Adjustments	Overstated \$10.0 million
Unspent Budget Authority – State Special Revenue Fund	Overstated \$2.1 million

Source: Compiled by Legislative Audit Division.

In addition, in fiscal year 2022, the office also established a new account in the state's Enterprise Fund with \$31.8 million in budget authority.

Because the office and Department of Administration staff did not pursue recording the MRA activity in the office's Enterprise Fund account by fiscal year-end, Budget Authority and Unspent Budget Authority are each overstated in the office's financial schedules. These parties have since determined the MRA activity should be incorporated into the state's ACFR by the Department of Administration rather than reflected in the office's financial schedules.

Although office staff worked closely with the Department of Administration, the entries were ultimately made based on incorrect accounting criteria, inaccurate guidance from Department of Administration, and an incomplete understanding of the purpose of the reinsurance state special revenue fund account. Internal controls were not sufficient to either prevent, or detect and correct, the unnecessary transactions prior to fiscal year-end. We classified this as a material weakness in internal controls in the Report on Internal Control and Compliance on page B-1.

RECOMMENDATION #2

We recommend the State Auditor's Office:

- A. *Enhance internal controls to fully consider applicable accounting criteria prior to recording transactions to the state's accounting records.*
- B. *Limit transactions recorded on the state's accounting records for discretely presented component units to those necessary, in accordance with generally accepted accounting principles.*

Controls Over Note Disclosures

Internal office reviews for initial and second draft note disclosures did not identify errors or omissions before submission for audit.

State accounting policy indicates management is responsible for establishing and maintaining agency internal controls to check the accuracy and reliability of financial data. State accounting policy also requires minimum note disclosures to accompany the financial schedules, in accordance with the regulatory basis financial reporting framework adopted by the Legislative Audit Committee. A disclosure template for financial schedules is made available from the Department of Administration. Although office staff used the template to prepare the note disclosures and subjected the note disclosures to several levels of review, internal controls were not effective and we identified the errors and omissions in our review. The missing information included a discussion of material misclassification of distributions to the retirement systems discussed in Recommendation #2 and disclosure of transactions between the office and the MRA as a related party. The office addressed the errors and omissions in the notes to the financial schedules included in this report.

Without effective internal control over drafting and reviewing the notes to the financial schedules, the office risks misleading users of its financial schedules. We classified this as a significant deficiency in internal controls in the Report on Internal Control and Compliance on page B-1.

RECOMMENDATION #3

We recommend the State Auditor's Office enhance internal controls over drafting and reviewing the financial schedule note disclosures to ensure disclosures are accurate and complete.

Schedule of Expenditures of Federal Awards Errors

The office did not properly classify \$17.7 million in federal waiver program subgrants on the Schedule of Expenditures of Federal Awards (SEFA) or submit the supporting subgrant schedule as required.

State agencies expending federal funds must annually report its activity on a SEFA submitted to the Governor's Office of Budget and Program Planning (OBPP). OBPP then compiles all SEFA information into a single document which is presented with the state's Basic Financial Statements. The office expends federal funds for the waiver program which subsidizes the Montana Reinsurance Program. Fiscal year 2022 was the second year the office expended funds for the program, but the first year with significant federal expenditures activity.

When preparing and submitting its fiscal year 2022 SEFA, the office did not properly classify the \$17.7 million in federal funds subgranted to the MRA and did not include the subaward schedule, as required by OBPP instructions. Office staff overlooked these requirements in the SEFA instructions, and office controls were not sufficient to either prevent, or detect and correct, the omissions before submitting the document to OBPP.

These errors existed in the original submission to OBPP. However, when we identified and communicated the errors to the office, they worked with OBPP to make necessary corrections.

RECOMMENDATION #4

We recommend the State Auditor's Office enhance internal controls to include a review for subgrant identification and the subaward schedule before submitting its SEFA package to OBPP.

Chapter III – Federal Findings and Recommendation

The Single Audit Act establishes auditing and reporting requirements for federal grant programs. A formula is applied to the state's federal expenditures to calculate a threshold. With exceptions for programs that meet low-risk criteria, federal grant programs with expenditures exceeding the threshold must be audited as part of the state's Single Audit. The office's federal Waivers for State Innovation for Section 1332 of the Patient Protection and Affordable Care Act (waiver program) meets this threshold. The waiver program represents the federal government's participation in the Montana Reinsurance Program discussed in Chapter II.

This chapter includes findings related to the waiver program required to be reported under federal regulations for the fiscal years 2022 and 2023 Single Audit period. The format and content of such findings is prescribed by federal regulations, 2 CFR 200.516, which is different than the narrative format provided in Chapter II. The internal control and compliance issues reported in Chapter III of this report are in the prescribed format for efficiency and consistency in incorporating them into the Single Audit report which will be issued in March 2024. The prescribed format includes six components described as follows:

- ◆ Criteria – the policy, regulation or other requirement that defines what should be.
- ◆ Condition – what happened?
- ◆ Questioned Costs – discloses amount of federal funds improperly used.
- ◆ Context – provides information to understand the significance of the issue.
- ◆ Cause – why did things go wrong?
- ◆ Effect – why is this issue important?

Requirements Related to Waiver Program Subgrants

Criteria: Sections 2 CFR 200.214 and 2 CFR 180.300 require the office to restrict subawards to parties not suspended or debarred from receiving federal funds. The waiver program compliance supplement further requires the office to review the System for Award Management (SAM) website annually for its subrecipients.

2 CFR 25.300 specifies subawards may not be made unless the subrecipient has obtained and provided its Unique Entity Identifier (UEI) to the federal grant recipient.

2 CFR 170 Appendix A the federal grant recipient must report each action that obligates federal funds to a subrecipient that equals or exceeds \$30,000. Each obligating action must be reported to the Federal Funding Accountability and Transparency Act (FFATA) Subaward Reporting System (FSRS) by the end of the month following the month in which the decision was made.

In addition, 2 CFR 200.303 requires non-Federal entities to, among other things, establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.

Condition: The office did not have adequate controls to identify all requirements related to its subaward under the waiver program, including the requirement to communicate specific information to its subrecipient, the Montana Reinsurance Association (MRA).

Additionally, the office did not comply with suspension and debarment and reporting requirements applicable to the waiver program, as follows:

- ◆ The office did not check the SAM excluded party list for suspensions and debarments and retain evidence of its review before issuing any subaward payments. Additionally, contrary to federal regulations, the office made subaward payments to the MRA prior to receiving its UEI.
- ◆ The office did not submit reports for subaward information as required under FFATA.

Questioned Costs: No questioned costs identified.

Context: There is a single subrecipient for the waiver program. The office did not check the suspended or debarred status of the subrecipient during the audit period. Additionally, the office did not submit the required FFATA reports for \$47.5 million in subawards made during fiscal years 2022 and 2023.

We brought the internal control and compliance issues to the office's attention in April 2023. As of June 14, 2023, the office updated its Annual Calendar used to track reporting and monitoring requirements. On this version of its Annual Calendar, the office scheduled an annual check of the SAM site for October 2023, but FFATA reporting was not yet incorporated into the calendar. On July 13, 2023, the office added FFATA reports to its Annual Calendar.

Additionally, as of June 30, 2023, the office had neither checked the SAM excluded party listing nor obtained the MRA's UEI. Between May and June 2023, the office incurred costs associated with the MRA totaling \$283,334 in federal funds.

Effect: The office has not complied with all elements of the Suspension and Debarment and Reporting compliance requirements. Internal control weaknesses also put the office at risk of additional noncompliance.

Cause: While the office treated the MRA as its subrecipient in some respects, the office did not identify the need to treat the MRA as a subrecipient for all related requirements.

The office relied on federal guidance provided when the state's waiver was approved in 2019, which included the Specific Terms and Conditions. However, the office did not consider other requirements outlined in the federal Compliance Supplement for the waiver program, available as of August 2019 and at recurring intervals since that time, when determining procedures necessary to comply with all federal compliance requirements.

RECOMMENDATION #5

We recommend the State Auditor's Office:

- A. *Enhance internal controls to monitor the excluded parties list, disclose all required information to its subrecipient, and complete required Federal Funding Accountability and Transparency Act reports.*
- B. *Comply with federal suspension and debarment requirements to review the SAM website prior to making subaward payments and to make subawards only to entities with a Unique Entity Identifier.*
- C. *Submit required Federal Funding Accountability and Transparency Act reports.*

Views of Responsible Officials: The office concurs with this recommendation.

Written Cash Management Policies

Criteria: Federal Health and Human Services (HHS) Grants Policy Statement specifies actions to manage the day-to-day operations of federal programs should include written policies and procedures.

In addition, 2 CFR 200.303 requires non-Federal entities to, among other things, establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.

Condition: The office does not have written policies and procedures to minimize the time elapsing between the transfer of funds from the federal cash draw system and the disbursement of those funds by the recipient, as required by the HHS Grants Policy Statement. Additionally, office internal controls did not identify that written policies and procedures were required. As part of our audit, we did not identify instances where the office held federal funds in the treasury longer than permitted by federal regulations.

Questioned Costs: No questioned costs identified.

Context: The waiver program was authorized in August 2019. Guidance to establish written policies and procedures is included in the HHS Grants Policy as early as 2007. The waiver program's compliance supplement specified this requirement as early as August 2019. As such, guidance outlining the requirement for written policies and procedures was available to the office at the time the program was authorized by the federal government.

As of June 16, 2023, the office provided written policies and procedures in draft form. The SAO Cash Management procedure was approved on August 3, 2023.

Effect: By not identifying the need to establish and maintain written policies and procedures over federal cash management requirements, the office has not complied with federal regulations applicable to the award. Additionally, the absence of documented policies and procedures puts the office at risk for noncompliance by drawing an incorrect amount from the federal government or holding federal cash in the state treasury for too long.

Cause: When developing policies and procedures for the waiver program, office personnel overlooked the need to establish written policies and procedures for federal cash management requirements.

RECOMMENDATION #6

We recommend the State Auditor's Office:

- A. *Enhance internal controls by ensuring written policies and procedures are developed for all aspects of the federal waiver program.*
- B. *Maintain written policies and procedures to minimize the time elapsing between the transfer of funds from the federal cash draw system and the disbursement of funds, as required by federal Health and Human Services Grants Policy.*

Views of Responsible Officials: The office concurs with this recommendation.

Internal Controls Over SF-425 Reporting

Criteria: Section 2 CFR 200.303 requires non-Federal entities to, among other things, establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.

Condition: The office did not document its review of the SF-425 Annual Report, a federal financial report used to provide the federal grantor agency with information about individual grant awards, prior to submission.

Questioned Costs: No questioned costs identified.

Context: There were two annual reports due during the audit period. Neither report contained documentary evidence of a review before submission. Our audit did not identify errors in information included in the federal SF-425 reports.

Effect: The absence of internal controls can result in incomplete, inaccurate, or late reporting to the federal government. The office risks noncompliance with federal reporting requirements without adequate internal controls.

Cause: The office overlooked the need to retain documentary evidence of its review of the SF-425 report prior to submission.

RECOMMENDATION #7

We recommend the State Auditor's Office enhance internal controls to include a review for accuracy and completeness of the SF-425 report is documented before submission.

Views of Responsible Officials: The office concurs with this recommendation.

Independent Auditor's Report and State Auditor's Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

A-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

REPORT ON THE AUDIT OF FINANCIAL SCHEDULES

Opinions

We have audited the financial schedules of the State Auditor's Office (office), which are comprised of the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out for each of the fiscal years ended June 30, 2022, and 2021, and the related notes to the financial schedules.

Qualified Opinions on Regulatory Basis of Accounting

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinions on Regulatory Basis of Accounting paragraph, the accompanying financial schedules for the fiscal years ended June 30, 2022 and June 30, 2021, present fairly, in all material respects, the results of operations and changes in fund equity for each of the fiscal years ended June 30, 2022, and 2021, in conformity with the basis of accounting described in Note 1.

Adverse Opinions on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles section of our report, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the office as of June 30, 2022 and June 30, 2021, or changes in financial position for the years then ended.

Basis for Qualified Opinions on Regulatory Basis of Accounting

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Schedules section of our report. We are required to be independent of the department and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Matters Giving Rise to Qualified Opinions on Regulatory Basis of Accounting

As described in Note 6b of the financial schedules, expenditures recorded for the Local Assistance to Counties program are incorrectly classified between expenditure accounts, resulting in misstatements for fiscal years 2022 and 2021. Additionally, as described in Note 6a of the financial schedules, the office recorded unnecessary entries related to Montana Reinsurance Association activity to its accounting records in fiscal year 2022. The following table summarizes misstatements identified.

Financial Schedule Line Item	2022 Over (Under) Stated	2021 Over (Under) Stated
<u>Schedule of Total Expenditures & Transfers-Out</u>		
Local Assistance to Counties		
From Other Sources	\$41.0 million	\$39.0 million
Intra-Entity Expense	(\$41.0 million)	(\$39.0 million)
Insurance		
Grants from State Sources	(\$2.1 million)	
Expenditures & Transfers Out by Fund – State Special Revenue Fund	(\$2.1 million)	
Actual Budgeted Expenditures & Transfers-Out	(\$2.1 million)	
Prior Year Expenditures & Transfers-Out Adjustments	\$10.0 million	
Budget Authority	\$38.1 million	
Unspent Budget Authority – State Special Revenue Fund	\$2.1 million	
Unspent Budget Authority – Enterprise Fund	\$38.1 million	
<u>Schedule of Changes in Fund Equity</u>		
State Special Revenue Fund		
Direct Entries to Fund Equity	(\$10.0 million)	
Budgeted Expenditures & Transfers-Out	(\$12.1 million)	
Prior Year Expenditures & Transfers-Out	\$10.0 million	
Ending Fund Equity	(\$7.9 million)	

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles

As described in Note 1 of the financial schedules, the financial schedules are prepared by the State Auditor's Office from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets and liabilities.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material and pervasive.

Emphasis of Matter

As discussed in Note 6 to the financial schedules, the office's expenditures to the Montana Reinsurance Association increased significantly between fiscal year 2021 and fiscal year 2022. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Schedules

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

In preparing the financial schedules, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the office's ability to continue as a going concern for twelve months beyond the financial schedule date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibility for the Audit of the Financial Schedules

Our objectives are to obtain reasonable assurance about whether the financial schedules as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial schedules.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- ◆ Exercise professional judgment and maintain professional skepticism throughout the audit.
- ◆ Identify and assess the risks of material misstatement of the financial schedules, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial schedules.
- ◆ Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the office's internal control. Accordingly, no such opinion is expressed.
- ◆ Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial schedules.
- ◆ Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the office's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2023, on our consideration of the office's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the office's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

April 4, 2023

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Custodial Fund	Private Purpose Trust Fund
FUND EQUITY: July 1, 2021	\$ (40,430,172)	\$ 16,096,015	\$ 0	\$ 0	\$ 11,411,461
ADDITIONS					
Budgeted Revenues & Transfers-In	117,742,965	71,571,125	17,723,226	8,746	1,561,178
Nonbudgeted Revenues & Transfers-In	6,515,882	2,509,151			
Prior Year Revenues & Transfers-In Adjustments	(4,071)	(11,698)			
Direct Entries to Fund Equity	(84,359,554)	(53,809,488)			
Total Additions	39,895,222	20,259,091	17,723,226	8,746	1,561,178
REDUCTIONS					
Budgeted Expenditures & Transfers-Out	40,971,260	4,032,888	17,698,226	8,746	638,108
Nonbudgeted Expenditures & Transfers-Out	73	10,033,585			
Prior Year Expenditures & Transfers-Out Adjustments	6,115	10,064,868	25,000		
Total Reductions	40,977,448	24,131,341	17,723,226	8,746	638,108
FUND EQUITY: June 30, 2022	\$ (41,512,398)	\$ 12,223,765	\$ 0	\$ 0	\$ 12,334,531

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Custodial Fund	Private Purpose Trust Fund
FUND EQUITY: July 1, 2020	\$ (39,833,200)	\$ 2,470,428	\$ 0	\$ 0	\$ 10,997,113
ADDITIONS					
Budgeted Revenues & Transfers-In	104,374,072	67,874,452	242,310		
Nonbudgeted Revenues & Transfers-In	6,493,276	367,928			807,545
Prior Year Revenues & Transfers-In Adjustments	(600)	(10,465)			
Direct Entries to Fund Equity	(72,437,364)	(39,894,478)			
Total Additions	<u>38,429,385</u>	<u>28,337,437</u>	<u>242,310</u>	<u>75,000</u>	<u>807,545</u>
REDUCTIONS					
Budgeted Expenditures & Transfers-Out	38,994,499	7,517,702	242,310		
Nonbudgeted Expenditures & Transfers-Out	64	7,181,118		75,000	393,197
Prior Year Expenditures & Transfers-Out Adjustments	(28,205)	13,029			
Total Reductions	<u>38,966,357</u>	<u>14,711,849</u>	<u>242,310</u>	<u>75,000</u>	<u>393,197</u>
FUND EQUITY: June 30, 2021	\$ <u>(40,430,172)</u>	\$ <u>16,096,015</u>	\$ <u>0</u>	\$ <u>0</u>	\$ <u>11,411,461</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Custodial Fund		Private Purpose Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS							
Licenses and Permits	\$ 19,572,305	\$ 17,451,590					\$ 37,023,895
Taxes	97,898,186	53,600,258					151,498,444
Charges for Services	2,330	159,699					162,029
Investment Earnings		9,042					9,042
Fines and Forfeits							266,073
Grants, Contracts, and Donations							1,561,178
Transfers-in	6,515,882	243,934					6,759,816
Intra-entity Revenue		235,440					235,440
Inception of Lease/Installment Contract		2,272,719					2,272,719
Miscellaneous		95,897					104,643
Federal			\$ 17,723,226				<u>17,723,226</u>
Total Revenues & Transfers-in	124,254,776	74,068,579					217,616,504
Less: Nonbudgeted Revenues & Transfers-in	6,515,882	2,509,151					10,594,957
Prior Year Revenues & Transfers-in Adjustments		(11,698)					(15,769)
Actual Budgeted Revenues & Transfers-in	\$ 117,742,965	\$ 71,571,125	\$ 17,723,226			\$ 0	<u>\$ 207,037,316</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Custodial Fund	Private Purpose Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS						
Licenses and Permits	\$ 17,053,422	\$ 17,176,737				\$ 34,230,159
Taxes	87,263,258	50,240,365				137,503,623
Charges for Services	1,869	223,592				225,461
Investment Earnings		6,223				6,223
Fines and Forfeits						54,922
Grants, Contracts, and Donations						807,545
Transfers-in						6,828,282
Intra-entity Revenue						214,715
Capital Asset Sale Proceeds						13,000
Inception of Lease/Installment Contract						3,791
Miscellaneous						93,489
Federal						242,310
Total Revenues & Transfers-in	110,866,749	68,231,915		75,000	807,545	180,223,519
Less: Nonbudgeted Revenues & Transfers-in	6,493,276	367,928		75,000	807,545	7,743,750
Prior Year Revenues & Transfers-In Adjustments	(600)	(10,465)				(11,065)
Actual Budgeted Revenues & Transfers-in	\$ 104,374,072	\$ 67,874,452		\$ 0	\$ 0	\$ 172,490,834

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

	Central Management	Insurance	Local Assistance to Counties	Securities	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT					
Personal Services					
Salaries	\$ 957,826	\$ 2,884,539		\$ 747,963	\$ 4,590,328
Employee Benefits	302,166	919,714		223,212	1,445,092
Total	<u>1,259,992</u>	<u>3,804,253</u>		<u>971,175</u>	<u>6,035,420</u>
Operating Expenses					
Other Services	138,339	531,126		111,297	780,762
Supplies & Materials	173,844	30,160		2,705	206,709
Communications	72,902	26,107		7,841	106,849
Travel	38,260	52,820		19,956	111,037
Rent	13,473	3,227		847	17,547
Repair & Maintenance	673	226		66	964
Other Expenses	59,804	96,449		29,058	185,310
Total	<u>497,294</u>	<u>740,115</u>		<u>171,769</u>	<u>1,409,178</u>
Equipment & Intangible Assets					
Intangible Assets	486,589	1,428,858		357,271	2,272,719
Total	<u>486,589</u>	<u>1,428,858</u>		<u>357,271</u>	<u>2,272,719</u>
Local Assistance					
From other sources			\$ 40,977,375		40,977,375
Total			<u>40,977,375</u>		<u>40,977,375</u>
Grants					
From State Sources		5,706,836			5,706,836
From Federal Sources		17,723,226			17,723,226
Total		<u>23,430,062</u>			<u>23,430,062</u>
Benefits & Claims					
From State Sources			341,706		341,706
From Other Sources		638,108			638,108
Total		<u>638,108</u>			<u>979,814</u>
Transfers-out					
Fund transfers		1,361,232		6,498,583	7,859,816
Total		<u>1,361,232</u>		<u>6,498,583</u>	<u>7,859,816</u>
Debt Service					
Lease Liability	110,247	323,391		80,848	514,485
Total	<u>110,247</u>	<u>323,391</u>		<u>80,848</u>	<u>514,485</u>
Total Expenditures & Transfers-Out	\$ 2,354,122	\$ 31,726,019	\$ 40,977,375	\$ 8,421,353	\$ 83,478,868
EXPENDITURES & TRANSFERS-OUT BY FUND					
General Fund					
State Special Revenue Fund	\$ 2,354,122	\$ 73	\$ 40,977,375		\$ 40,977,448
Federal Special Revenue Fund		13,364,612		\$ 8,412,607	24,131,341
Custodial Fund		17,723,226			17,723,226
Private Purpose Trust Fund		638,108		8,746	8,746
Total Expenditures & Transfers-Out	2,354,122	31,726,019	40,977,375	8,421,353	83,478,868
Less: Nonbudgeted Expenditures & Transfers-Out	497,202	3,317,101		6,866,209	10,680,512
Prior Year Expenditures & Transfers-Out Adjustments	15,721	10,073,978	6,115	168	10,095,983
Actual Budgeted Expenditures & Transfers-Out	1,841,198	18,334,940	40,971,260	1,554,976	62,702,374
Budget Authority	2,550,848	82,016,841	41,298,412	2,194,923	128,061,024
Unspent Budget Authority	<u>709,650</u>	<u>63,681,902</u>	<u>327,152</u>	<u>639,947</u>	<u>65,358,650</u>
UNSPENT BUDGET AUTHORITY BY FUND					
General Fund					
State Special Revenue Fund	\$ 709,650	\$ 15,480,127		\$ 639,947	\$ 16,829,724
Federal Special Revenue Fund		16,401,774			16,401,774
Enterprise Fund		31,800,000			31,800,000
Unspent Budget Authority	<u>709,650</u>	<u>63,681,902</u>	<u>327,152</u>	<u>639,947</u>	<u>65,358,650</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2021

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Central Management	Insurance	Local Assistance to Counties	Securities	Total
Personal Services					
Salaries	\$ 896,295	\$ 2,612,067		\$ 745,190	\$ 4,253,552
Employee Benefits	317,154	944,991		256,935	1,519,080
Total	<u>1,213,450</u>	<u>3,557,057</u>		<u>1,002,125</u>	<u>5,772,632</u>
Operating Expenses					
Other Services	116,848	489,818		139,485	746,151
Supplies & Materials	80,488	8,428		4,789	93,706
Communications	64,106	24,441		7,926	96,474
Travel	7,556	11,299		4,033	22,887
Rent	112,514	317,715		84,385	514,614
Repair & Maintenance	481	208		59	748
Other Expenses	63,104	155,440		96,122	314,665
Total	<u>445,097</u>	<u>1,007,349</u>		<u>336,799</u>	<u>1,789,245</u>
Local Assistance					
From other sources			\$ 38,966,294		\$ 38,966,294
Total			<u>38,966,294</u>		<u>38,966,294</u>
Grants					
From Federal Sources		242,310			\$ 242,310
Total		<u>242,310</u>			<u>242,310</u>
Benefits & Claims					
From State Sources			50,000		50,000
From Other Sources		393,197			393,197
Total		<u>393,197</u>		<u>50,000</u>	<u>443,197</u>
Transfers-out					
Fund transfers		284,299		6,885,022	7,169,321
Total		<u>284,299</u>		<u>6,885,022</u>	<u>7,169,321</u>
Debt Service					
Capital Leases	1,791	3,085		839	5,715
Total	<u>1,791</u>	<u>3,085</u>		<u>839</u>	<u>5,715</u>
Total Expenditures & Transfers-Out	\$ 1,660,338	\$ 5,487,297	\$ 38,966,294	\$ 8,274,785	\$ 54,388,714
EXPENDITURES & TRANSFERS-OUT BY FUND					
General Fund		\$ 64	\$ 38,966,294		\$ 38,966,357
State Special Revenue Fund	\$ 1,660,338	4,851,726		\$ 8,199,785	14,711,849
Federal Special Revenue Fund		242,310			242,310
Custodial Fund			75,000		75,000
Private Purpose Trust Fund		393,197			393,197
Total Expenditures & Transfers-Out	<u>1,660,338</u>	<u>5,487,297</u>	<u>38,966,294</u>	<u>8,274,785</u>	<u>54,388,714</u>
Less: Nonbudgeted Expenditures & Transfers-Out	3,791	677,466		6,968,122	7,649,379
Prior Year Expenditures & Transfers-Out Adjustments	232	7,699	(28,205)	5,098	(15,176)
Actual Budgeted Expenditures & Transfers-Out	<u>1,656,315</u>	<u>4,802,132</u>	<u>38,994,499</u>	<u>1,301,566</u>	<u>46,754,511</u>
Budget Authority	2,431,926	50,769,175	39,144,843	1,770,149	94,116,093
Unspent Budget Authority	<u>775,611</u>	<u>45,967,044</u>	<u>150,344</u>	<u>468,584</u>	<u>47,361,583</u>
UNSPENT BUDGET AUTHORITY BY FUND					
General Fund			\$ 150,344		\$ 150,344
State Special Revenue Fund	\$ 775,611	\$ 12,109,354		\$ 468,584	13,353,548
Federal Special Revenue Fund		33,857,690			33,857,690
Unspent Budget Authority	<u>775,611</u>	<u>45,967,044</u>	<u>150,344</u>	<u>468,584</u>	<u>47,361,583</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

State Auditor's Office
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2022

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue). In applying the modified accrual basis, the office records:

- ◆ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ◆ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual and sick leave when used or paid.

The office uses accrual basis accounting for its Fiduciary (Private-Purpose Trust and Custodial) fund categories. Under the accrual basis, as defined by state accounting policy, the office records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The office uses the following funds:

Governmental Fund Category

- ◆ **General Fund** – to account for all financial resources except those required to be accounted for in another fund. The General Fund includes revenue from insurance premium tax, securities brokerage licenses, fines and penalties, and transfers in from securities and captive insurance state special revenue funds. The expenditures included in the General Fund are (i) fund transfers to Montana Public Employee's Retirement Administration, (ii) expenditures to each city or town with a fire relief association or a police department not participating in the municipal police officer's retirement system, and (iii) Insure Montana activity.
- ◆ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures

for specific state program purposes. The office's State Special Revenue Funds include Insurance and Securities Division activity, such as securities portfolio registration revenue, insurance license revenue, examination fees, industry continuing education programs, Insure Montana activity, and the Patient Protection and Affordable Care Act (ACA) Section 1332 Innovation Waiver assessments.

- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. The office's Federal Special Revenue Fund includes the ACA Section 1332 Innovation Waiver grant, which assists in the stabilization of the individual health insurance market.

Fiduciary Fund Category

- ♦ **Private-Purpose Trust Fund** – to account for all fiduciary activities that are (a) not required to be reported in pension (and other employee benefit) trust funds or investment trust funds and (b) are held in a trust (or trust equivalent arrangement), where the principal and income benefit individuals, private organizations, or other governments. The office's Private Purpose Trust Fund includes financial deposits required to be held in trust by the office for insurance companies licensed in Montana.
- ♦ **Custodial Fund** – to account for resources of fiduciary activities held by the state in a custodial capacity which are not required to be reported in pension (and other employee benefit) trust funds, investment trust funds, or private-purpose trust funds. The external portion of investment pools that are not held in a trust should be reported in a separate external investment pool fund column, under the custodial fund classification. Custodial funds may be used on a limited basis for internal (to the State) clearing account activity, but these must have a zero balance at fiscal year-end. The office's custodial funds include pass-through activity.

Changes in Accounting Policy

Beginning in Fiscal Year 2022, the State of Montana implemented GASB 87 – Leases, which generally requires long-term leases to be recorded as a liability and a corresponding right-to-use lease asset. Since these leases are accounted for as long-term debt, governmental funds will show a Non-Budgeted, Inception of Lease/Installment Contract category on the Schedule of Revenues and Transfers-in and a corresponding Non-Budgeted Expenditure on the Schedule of Total Expenditures and Transfers-out for the purchase of the leased asset. In the Schedule of Total Expenditures and Transfers-Out for Fiscal Year 2022, the debt service transfer was \$514,485 for rent expenditures. Due to the office's rent expense being greater than \$100,000 and for a term exceeding one year, it is considered a long-term lease under GASB 87.

2. General Fund Equity Balance

The negative fund equity balance in the General Fund does not indicate overspent appropriation authority. The office has authority to pay obligations – within its appropriation limits – from the statewide General Fund. The office uses cash (or other assets) from this statewide fund to pay its General Fund obligations. For each of the fiscal years ended June 30, 2021 and June 30, 2022, the office's outstanding liabilities exceeded the assets it had placed in the fund – resulting in negative ending General Fund equity balances for each of these fiscal years.

3. Direct Entries to Fund Equity

Direct entries to fund equity in the General and State Special Revenue funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Direct entries to fund equity in the State Special Revenue funds also include a correcting entry to fiscal year 2021 (done in fiscal year 2022) of \$10,038,801 that understated fund equity. This journal entry was made based on the office's best effort and beliefs at that time in preparation for establishing the new Montana Reinsurance Association (MRA) component unit. As a result of continued collaborative discussions with the State Accounting Bureau (SAB) and the Office of Budget and Program Planning (OBPP) in establishing the MRA component unit, this entry will be modified and will result in a correcting entry to reflect accurate fund balances as of fiscal year-end 2023.

4. Unspent Budget Authority

The Schedule of Total Expenditures and Transfers-Out for fiscal years 2021 and 2022 presents unspent budget authority. The following table presents the office's material portions of unspent budget authority.

Fiscal Year 2021 Unspent Budget Authority

	Payments to MRA	Unspent Authority	Unspent Authority Reason(s)
State Special	\$ 242,310	\$ 9,931,143	Due to timing of the MRA Program startup.
Federal Special	-	\$ 33,857,690	Due to the timing of the MRA Program startup.

Fiscal Year 2022 Unspent Budget Authority

	Payments to MRA	Unspent Authority	Unspent Authority Reason(s)
State Special	\$ 5,706,836	\$ 14,155,450	MRA claims payments lower than estimated.
Enterprise	-	\$ 31,800,000	Enterprise fund for MRA component unit activity.

5. Montana Reinsurance Association (MRA) Related Party Relationship

In April 2019, the State of Montana enacted the Montana Reinsurance Association Act (Act) establishing the MRA as a nonprofit, legal entity and creating a reinsurance program to stabilize the individual health insurance market. The Act is established under Title 33, Chapter 22, Part 13 of the Montana Code Annotated (MCA).

The Act authorized the state to apply for a State Innovation Waiver under Section 1332 of the ACA. On June 19, 2019, the state applied for an Innovation Waiver under Section 1332 seeking to implement a reinsurance program. On August 16, 2019, the United States Departments of Health and Human Services and Treasury approved Montana's State Innovation Waiver, effective from January 1, 2020, through December 31, 2024.

The MRA is funded through federal pass-through funding (awarded on an annual basis) and annual association member assessments (1.2% of a member insurer's total premium volume covering Montana residents from the prior calendar year, as defined in Section 33-22-1313, MCA).

The MRA is governed by a five-member board consisting of three directors, one each from the eligible health insurers with the largest enrollment in the individual market, one insurer director appointed by the Commissioner of Insurance, and one director appointed by the Governor. For more information, visit the MRA website at mtreinsurance.org.

The MRA is a component unit of the state. MRA financial results are included in the state's Annual Comprehensive Financial Report because of the financial significance of MRA relationship with the state. The MRA financial reports (prepared on a calendar year basis) must be audited by an independent certified public accountant annually and may be audited by the state's Legislative Audit Division.

The following tables outline the transactions from the SAO accounting system for the following years:

Fiscal Year 2021 ACA Section 1332 Innovation Waiver Expenditures

	Operations	Claims	Total
State Special	-	-	-
Federal Special	\$242,310	-	\$242,310

Fiscal Year 2022 ACA Section 1332 Innovation Waiver Expenditures

	Operations	Claims	Total
State Special	-	\$7,818,990	\$7,818,990
Federal Special	\$332,695	\$17,390,531	\$17,723,226

6. Material Misstatements

a. **Montana Reinsurance Association (MRA).** During the fiscal year 2021 and 2022 legislative audit, it was identified that year-end journal entries were recorded incorrectly. These entries were related to the new statutorily created MRA and made to establish the MRA as a component unit. The office set up the MRA component unit based on its best efforts and belief that this was the most appropriate way to account for MRA financial transactions after collaborating with the State Accounting Bureau (SAB) and the Office of Budget and Program Planning (OBPP). Based on continued collaborative discussions with SAB and OBPP, the office determined it was best to use the paper method presentation for transparency. As a result, this office will modify the year-end journal entries for 2021 and 2022, which will result in correcting entries. These adjusting entries will be made to reflect correct fund balances as of fiscal year-end 2023.

FY 2022 Schedule of Total Expenditures & Transfers-Out

- ◊ Prior Year Expenditures and Transfers-Out Adjustments are overstated by \$10.039 million State Special Revenue Fund (SSRF).
- ◊ Grants from State Sources are understated by \$2.112 million (SSRF).
- ◊ Total Expenditures and Transfers-Out are understated by \$2.112 million (SSRF). (Note: This is a sum of the \$10.039 million prior year entry and \$12.151 million current year entry).
- ◊ Unspent Budget Authority is overstated by \$12.151 million (SSRF) and \$31.8 million (Enterprise Fund).

FY 2022 Schedule of Changes in Fund Equity

- ◊ Prior Year Expenditures and Transfers-Out Adjustments are overstated by \$10.039 million (SSRF).
- ◊ Direct Entries to Fund Equity is overstated by \$10.039 million (SSRF).
- ◊ Budgeted Expenditures and Transfers-Out is understated by \$12.151 million (SSRF).
- ◊ Ending Fund Equity is understated by \$7,927 million (SSRF).

b. Montana Public Employees Retirement Administration (MPERA). The office processes general fund distributions to MPERA for the Municipal Police Officer's Retirement System (MPORS) and the Firefighter's Unified Retirement System (FURS) using account code 65311. These distributions are required by Sections 19-9-702 and 19- 13-604, MCA, respectively. The current account code range (65%) is used for state-to- local government transactions. Due to MPERA being a component unit of the state, the updated account coding (689%) should be used for transfers to the component unit. This account coding is for primary government to component unit transactions.

For FY 2021, MPORS and FURS payments of \$38,966,294 were coded to the 65311 state- to-local government account code. For FY 2022, MPORS and FURS payments of \$40,971,260 were coded to the 65311 state-to-local government account code. Beginning in FY 2023, the account coding for these distributions will be the updated transfers to component unit account code (689%). This ensures ACFR accuracy and standardizes statewide entries of this type to MPERA. For FY 2021 the state-to-local government account was overstated by \$38,966,294, in turn, the transfers to component unit account code were understated by this amount. For FY 2022 the state-to-local government account was overstated by \$40,971,260, in turn, the transfers to component unit account code were understated by this amount.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the State Auditor's Office (office) for each of the fiscal years ended June 30, 2022, and 2021, and the related notes to the financial schedules, and have issued our report thereon dated April 4, 2023. Our report includes qualified opinions on the financial schedules for each of the fiscal years ended June 30, 2022, and 2021.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the office's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of office's internal control. Accordingly, we do not express an opinion on the effectiveness of office's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described below to be material weaknesses.

- ♦ As described in Recommendation #1, office internal controls did not prevent or timely detect and correct \$40 million in misclassified transactions in fiscal years 2022 and 2021.

- ◆ As described in Recommendation #2, office internal controls did not prevent or timely detect and correct unnecessary accounting entries related to a new federal program in fiscal year 2022 which resulted in material misstatements in the office's financial schedules.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention by those charged with governance. We consider the deficiencies described below to be significant deficiencies.

- ◆ As described in Recommendation #3, office internal controls to prepare and review financial schedule note disclosures did not produce complete and accurate disclosures presented for audit.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the office's financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial schedules. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

State Auditor's Office Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the office's response to the findings identified in our audit as described on page C-1 of this report. The office's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the office's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the office's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

April 4, 2023

STATE AUDITOR'S OFFICE

OFFICE RESPONSE



COMMISSIONER OF SECURITIES AND INSURANCE

Troy Downing
Commissioner

Office of the
Montana State Auditor

August 17, 2023

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LEGISLATIVE AUDIT DIV.

Angus Maciver, Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620

RE: Financial Compliance Audit #22-20: State Auditor's Office

Dear Mr. Maciver,

The State Auditor's Office (SAO) has reviewed the Financial Compliance Audit for the two fiscal years ending June 30, 2022. The SAO would like to thank you and your staff for their review. This office appreciates any opportunity to help improve its processes and better serve the people of Montana. Our responses to the recommendations are listed below:

Recommendation #1:

We recommend that the State Auditor's Office:

A. Enhance internal controls to ensure transfers to Montana Public Employees' Retirement Administration are accurately classified in the state's accounting records.

B. Ensure Transfers to Montana Public Employees' Retirement Administration are recorded as intra-entity expense, as required by state accounting policy.

Response:

Concur. The SAO makes mandated contributions to Montana Public Employees' Retirement Administration (MPERA) funds for certain retired municipal police and firefighters pursuant to § 19-9-702, MCA, § 19-13-604, MCA, and § 19-17-301, MCA. These contributions had historically been classified as local assistance to counties. Going forward, SAO will ensure that transfers to MPERA are classified as intra-entity expenses. The SAO will also incorporate the review and consideration of account classifications per the Montana Operations Manual (MOM) policies when completing financial analysis.

Angus Maciver, Legislative Auditor
August 17, 2023

Recommendation #2:

We recommend that the State Auditor's Office:

A. Enhance internal controls to fully consider applicable accounting criteria prior to recording transactions to the state's accounting records.

B. Limit transactions recorded on the state's accounting records for discretely presented component units to those necessary, in accordance with generally accepted accounting principles.

Response:

Concur. As noted in the audit report, the SAO worked closely with state partners when implementing the Montana Reinsurance Association (MRA). Relying on the advice provided, SAO recorded entries meant to "correct" the accounting records that had initially been recorded appropriately. The SAO has clarity on the classification of the MRA and how program funds should be categorized moving forward and will enhance controls through additional training in the areas identified. SAO has made the appropriate corrective entries to properly classify funds for the reinsurance program.

Recommendation #3:

We recommend that the State Auditor's Office enhance internal controls over drafting and reviewing the financial schedule note disclosures to ensure disclosures are accurate and complete.

Response:

Concur. Additional training will be provided to the SAO team that drafts and reviews the financial schedule note disclosures to ensure accuracy and completeness.

Recommendation #4:

We recommend that the State Auditor's Office enhance internal controls to include a review for subgrant identification and the subaward schedule before submitting its SEFA package to OBPP.

Response:

Concur. SAO promptly contacted the Office of Budget Program and Planning staff and updated the current Schedule of Expenditures of Federal Awards (SEFA) report to properly classify and account for the pass-through funds paid to MRA. SAO updated its procedures to implement the recommended internal controls on January 31, 2023.

Angus Maciver, Legislative Auditor
August 17, 2023

Recommendation #5:

We recommend that the State Auditor's Office:

- A. Enhance internal controls to monitor the excluded parties list, disclose all required information to its subrecipient, and complete required Federal Funding Accountability and Transparency Act [FFATA] reports.*
- B. Comply with federal suspension and debarment requirements to review the SAM website prior to making subaward payments and to make subawards only to entities with a Unique Entity Identifier.*
- C. Submit required Federal Funding Accountability and Transparency Act reports.*

Response:

Concur. When the reinsurance program was established and the Centers for Medicare and Medicaid Services (CMS) granted a section 1332 waiver for the program to operate, the CMS approval was accompanied by a list of Specific Terms and Conditions (STCs) that laid out SAO's obligations with respect to reporting and monitoring. The SAO relied on the STCs and worked diligently to implement the program in compliance with federal regulations. The SAO Calendar of Events accounting for required tasks has since been updated to include the additional federal requirements identified as an internal control to ensure compliance moving forward. The calendar lists each requirement, the timeline of completion, and the assigned individual or team. This includes searching SAM.gov to ensure that MRA is not debarred from federal contracting, making formal disclosures to MRA regarding the subaward, and ensuring that FFATA reports are filed. These measures are in addition to SAO's existing oversight, which has included regularly communicating with the MRA board chair and administrator and attending quarterly meetings as an ex officio member per § 33-22-1307(1)(e), MCA. Prior to its creation by SB 125 in 2019, MRA was not (and practically could not be) debarred from federal contracting, nor has MRA been debarred from federal contracting at any time since its creation. In addition, the MRA has obtained the Unique Entity Identifier for SAO's use going forward.

Recommendation #6:

We recommend that the State Auditor's Office:

- A. Enhance internal controls by ensuring written policies and procedures are developed for all aspects of the federal waiver program.*
- B. Maintain written policies and procedures to minimize the time elapsing between the transfer of funds from the federal cash draw system and the disbursement of funds, as required by Federal Health and Human Services Grants Policy.*

Angus Maciver, Legislative Auditor
August 17, 2023

Response:

Concur. SAO has adopted a written policy to address all concerns identified in this section of the audit report. Specifically, SAO adopted a cash management policy that formalized the processes that were already in use by SAO staff in handling program funds. In accordance with federal requirements, federal funds were never held longer than three days before being disbursed.

Recommendation #7:

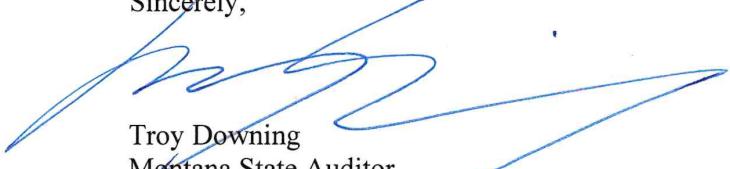
We recommend that the State Auditor's Office enhance internal controls to include a review for accuracy and completeness of the SF-425 report is documented before submission.

Response:

Concur. As of May 26, 2023, SAO has adopted an additional layer of review before submitting the SF-425 report. This additional layer of review was conducted before the 2023 SF-425 report was submitted to CMS. CMS has accepted all SF-425 submissions and did not identify any errors in any of SAO's SF-425 submissions.

SAO looks forward to implementing any appropriate corrective measures that have not already been adopted by SAO.

Sincerely,



Troy Downing
Montana State Auditor
Commissioner of Securities and Insurance